Additional Views on H.R. 5072, "FHA Reform Act of 2010"

The FHA program is in dire need of real reform. I applaud Administrator Stevens for submitting changes to Congress; however, H.R. 5072, the FHA Reform Act of 2010 does not do enough to ensure the stability of the FHA program so it never reaches the tipping point of a future taxpayer bailout. To further illustrate my views on FHA reform, I have included the text of an article I wrote for Investor's Business Daily which was published on February 18, 2010. H.R. 5072, the FHA Reform Act of 2010, stops short of the necessary reforms I would like to see made to the FHA program.

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RISKY MORTGAGE PRACTICES LIVE ON AT FEDERAL HOUSING ADMINISTRATION
(BY REPRESENTATIVE TOM PRICE)

Current economic and fiscal challenges demand a critical review of all federal programs with an eye toward positive, responsible reform. The Federal Housing Administration is one such program crying out for oversight and assessment. By every accounting measure, those used by private industry as well as government auditors, the FHA is bankrupt.

If the FHA were treated like a bank, it would be labeled as `critically undercapitalized' and folded up. By law, the agency is required to hold a 2% capital reserve. Yet according to its most recent actuarial review, it currently holds just a quarter of that, 0.53%.

The FHA, however, is not a bank, and we all know the White House would never allow it to fail. This is because the FHA is a key cog in today's government-monopolized housing industry, serving as one of the primary tools wielded by the administration in its mortgage modification efforts.

It's clear that the White House has not learned much from the mortgage meltdown, because rather than working to tamp down risky borrowing and mortgage practices, it is using the FHA to place them under the growing umbrella of federal backstops.

A look back at the rise and bust of the housing market reveals that the danger of the over-leveraging which we had hoped would be tempered is now increasingly taking place at the FHA, on the taxpayers' dime and watch.

The FHA serves as a federally backed mortgage insurance program. It does not originate loans, but instead guarantees 100% of loan principal for borrowers and lenders. It insures loans up to a whopping $729,750, and requires a mortgage insurance premium, but only asks for a 3.5% down payment. If a borrower fails to pay his mortgage, the FHA steps in and pays the lender for the loss on the property.

During the housing boom, the FHA saw a decrease in its market share, as borrowers could get more-attractive loan terms, for less money, from a private lender. And during this time, as more-qualified borrowers moved away from the FHA, less-qualified borrowers replaced them.

From 2004 through 2007, those with FICO scores below 620, generally considered subprime borrowers, made up 35% to 45% of the FHA's entire loan portfolio. Conversely, borrowers with a strong FICO score of 700 or higher represented just 10% to 15% of its portfolio.

In recent years, as the deterioration of the housing market became evident, private lenders began requiring higher down payments from borrowers and implemented more stringent underwriting standards. This could have been a helpful cleansing of bad practices. Instead, borrowers flocked to the FHA with its 3.5% down payment and 100% federal guarantee.

In a response, which one could only deem a `day late and a dollar short,' last month FHA Director David Stevens announced measures to strengthen the FHA's capital reserves. Borrowers with FICO scores under 580--below subprime--will now be required to have a 10% down payment, an embarrassingly timid response.

It raises the question, after all that's happened, should the government really be in the business of guaranteeing mortgages at subprime and below?

At the end of the 2009 fiscal year, the FHA guaranteed $685 billion and now insures an enormous 30% of all new home loan originations and 20% of refinanced loans. Plus, given the current conditions in the housing market, an unbelievable 80% of new borrowers with FHA guaranteed loans are first-time homebuyers.

And with FHA dabbling in the riskiest of loans and heavily leveraged, we sadly expect the FHA's troubles to get worse before they get better. Astoundingly, as heard recently in testimony before the House Financial Services Committee, the agency has not accurately calculated borrowers who are already behind on mortgage payments into FHA's loss projections.

But the really devastating inevitability is that taxpayers are in store for another open-ended bailout. As currently structured, excess premiums taken in by FHA are returned to the U.S. Treasury. But if the FHA's loan guarantee losses exceed its premiums, then the Treasury covers the difference.

FHA's recent actuarial report notes that there is likely to be a continued decline in its portfolio through 2011. According to testimony before the House Financial Services Committee, the bailout of the FHA could reach $54 billion or more. So taxpayers who are already enraged by the era of stimulus and bailouts need look no further than this agency for the next episode of federal intervention.

Put simply, it is time for a change in how the FHA operates. The agency must not compromise its underwriting standards in good times because private industry can offer a better product at a more competitive price. The FHA was not designed to replace the private loan market.

Additionally, Congress must do its part to ensure that the FHA does not put the taxpayer at unnecessary and avoidable risk. This includes appropriately increasing the FHA down payment requirement to be more aligned with the risk its borrowers pose to the taxpayer.

Most importantly, lenders should no longer be given a free, government-guaranteed ride with a 100% loss guarantee. As the FHA has rightly recognized, a 100% government guarantee with no lender `skin in the game' has eroded the solvency of FHA's balance sheet. While the agency has made some efforts to get tougher on lenders, the damage has already been done.

Moving forward, in addition to an increase in down payment by borrowers, lenders must be subject to more stringent and regular oversight, and losses must first be taken by the lender before the government guarantee begins.

Americans are calling for an end to the era of stimulus and bailouts. It's time for Washington to get tough with the FHA and straighten out its balance sheet. Failure to do so will only prolong the economic difficulties facing the housing sector and our great nation.

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